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C O N F I D E N T I A L SECTION 01 OF 02 KYIV 002147

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TAGS: [EFIN](#) [EREL](#) [ETRD](#) [PGOV](#) [PINR](#) [UP](#) [XH](#)
SUBJECT: UKRAINIAN FINANCE MINISTRY GRIM ON BUDGET

REF: A. KYIV 2140
[B](#). KYIV 2133
[C](#). KYIV 2130

Classified By: Economic Counselor Edward Kaska for Reasons 1.4 (b) and (d)

[1](#). (C) Summary. In preparation for DPM Nemyria's talks with IMF officials on December 17 and 18 (ref A), the GOU's top budget experts met with Kyiv-based IMF resident representative Max Alier to reconcile revenue and expenditure figures for 2009 and the first quarter of 2010. Talking separately with Econoff on December 15, Deputy Finance Minister Myarkovskiy said that the GOU had a shortfall of \$3 billion over the next six weeks, taking into account only minimum social expenditures and the January 7 Gazprom payment. Separately, Deputy Minister of Finance Kravets told us the GOU had successfully sold UAH 400 million (\$50 million) in one and three-year notes on December 15 in an attempt to cover roughly UAH 2 billion (\$250 million) in domestic debt payments due in late December. End summary.

CRITICAL SHORTFALL OVER NEXT SIX WEEKS

[2](#). (C) Working furiously with the IMF's Alier on budget figures prior to traveling to the U.S. on December 16 with DPM Nemyria and acting Finance Minister Umanskiy, Myarkovskiy told us that, at a minimum, the GOU had a UAH 8.8 billion (\$1.1 billion) deficit for remaining December wage and pension expenditures. The Ministry of Finance projected it would have a further deficit of UAH 6 billion (\$825 million) for similar minimum social expenditures in January.

[3](#). (C) Myarkovskiy said there was an additional \$1.2 billion needed for the January 7 gas payment, as the GOU wanted to import as much gas as possible in December due to 2010 price increases. Although not confirming what DPM Nemyria and Naftohaz spokesman Valentyn Zemlyansky separately reported to us (ref A), Myarkovskiy's figures suggest the GOU is firmly focused on importing approximately 5.5 billion cubic meters (bcm) this month.

[4](#). (C) The Ministry of Finance confirmed that these minimum social and gas payment obligations, which PM Tymoshenko considered essential expenditures over the next six weeks, would total over \$3 billion. Myarkovskiy's figure explicitly does not account for shortfalls on other protected budget items, including government operations. In fact, Deputy Minister of Economy Maksiuta lamented to us that the Cabinet of Ministers no longer had money to fill up official vehicles with gasoline, pointing to the fact that he had taken public transportation to attend the embassy's holiday party.

EMPTY DECEMBER COFFERS

15. (C) Myarkovskiy did not disclose figures on GOU revenues for December, except to say they were very low and the state treasury's "cupboard was bare". Making some spot calculations, he determined that the treasury had UAH 1.77 billion (\$221 million) in IMF Special Drawing Rights (SDR) remaining. When asked whether these SDRs would be used for January 7 gas payments, Myarkovskiy demurred, noting instead that the IMF was forcing Naftohaz to spend its revenues on the payment to Gazprom, rather than transferring December revenues to the government for budget payments. (Note: We have not received clarification from the IMF on this demand. End note.) The Deputy Minister of Finance did not mention whether shortfalls would be made up by NBU monetization or domestic debt issuance.

CLEVER ACCOUNTING ON CORE DEFICIT

16. (C) Ukraine's total 2009 budget deficit would be UAH 55 billion (\$6.88 billion), excluding Naftohaz's deficit and bank recapitalization financing, a figure that would allow the GOU to claim that its deficit was in line with IMF targets. Myarkovskiy admitted the IMF had been forced to "reconcile" the GOU's revenue figures. At issue specifically was whether a UAH 3 billion (\$375 million) loan to Ukravtodor, the state highway company, could be counted as revenue to help the GOU meet the IMF's target. Deputy Minister of Economy Maksiuta told us later on December 15 that the IMF had acquiesced on the GOU's accounting of the

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Ukravtodor loan as revenue. In addition to the Ukravtodor monies, as well as loans from the World Bank and the IMF's second and third tranches that provided budget assistance earlier in 2009, over \$2 billion in IMF Special Drawing Rights had been apportioned as revenue by GOU accountants, allowing PM Tymoshenko to declare that Ukraine's state budget had been "fulfilled" through November.

Q1 2010 PROJECTIONS

17. (C) Myarkovskiy said that the Ministry of Finance was projecting the Q1 2010 budget deficit to be UAH 14.3 billion (roughly \$1.79 billion, excluding Naftohaz's deficit and bank recapitalization financing). Confirming Naftohaz Chairman Oleh Dubinya's November 27 statement, Myarkovskiy said the GOU planned to import 7 bcm from Gazprom in Q1 2010. As a result, based on a \$300-310 tcm price (and as projected by Gazprom Sbyt on December 17), the GOU would need to pay at least UAH 16.8 billion (\$2.1 billion) for imported gas in Q1 2010, according to Myarkovskiy.

DECEMBER DEBT AUCTION

18. (C) Deputy Finance Minister Kravets told Econoff on December 15 that the Ministry had sold UAH 400 million (\$50 million) in domestic securities. The one-year notes went at 24% and the three-year notes sold at 25%, he said. There was no appetite for three-month notes, according to Kravets. The Deputy Minister had told us on December 11 that the new securities were being issued to cover roughly UAH 2 billion (\$250 million) in domestic payments due in December, otherwise Ukraine would default on these obligations, possibly triggering calls for accelerated payments on other debt (ref C). Kravets' numbers closely corresponded with IMF calculations for December domestic debt payments (ref B).

19. (C) Kravets was actively marketing the next debt auctions (scheduled on December 22 and 29) to at least three of our foreign banking contacts (OTP, Ukrsibbank/BNP Paribas, and UniCredit) at the embassy holiday reception on December 15.

All then reported to us that they had not bought securities on December 15. Speaking separately, UniCredit CEO Federico Russo admitted that he had been eyeing six-month notes, and that he had already purchased GOU securities earlier in 2009.

Russo reasoned that shorter maturities would be too tied up in election-related political risk (and may not be paid out).

However, having a slightly longer maturity horizon would not only provide the bank favorable yields, there were few other avenues to make money, due to the abundance of risk and the lack of favorable lending opportunities on the Ukrainian market.

COMMENT

110. (C) The government has made expenditure calculations based on absolute minimum priorities to get to the second round of the presidential election. Now that the IMF has apparently given in on accounting tricks that will allow the GOU to meet IMF budget deficit targets by including loans and SDRs as budget revenue, the GOU will continue to focus its efforts on avoiding arrears in social and gas payments, while keeping a wary eye on debt obligations that could trigger lenders to demand early repayment in an "event of default" scenario. Without further sources of budget financing (in the form of a partial IMF tranche or monetization), we expect a major fiscal adjustment in December 2009 and the first quarter of 2010 will result.

TEFFT